

11 March 2020

Product Regulation
Strategic Policy
Australian Securities and Investment Commission
GPO Box 9827
Brisbane QLD 4001

By e-mail: product.regulation@asic.gov.au

Dear Sir / Madam

I write in response to consultation paper 325: Product Design and Distribution Obligations (DDO). Equity Trustees (EQT) is a holder of four Australian Financial Services Licenses (AFSL's) relating to the provision of Trustee and Responsible Entity services across the superannuation, managed investment and traditional trustee sectors. EQT is impacted primarily as a product issuer by the obligations.

EQT notes the regulatory intent behind the DDO to "rebalance the onus for effecting good consumer outcomes, and avoiding poor ones, in the provision of financial products" together with the reduction on the reliance on mandatory disclosure information as the primary mechanism to drive good consumer outcomes.

As an unconflicted, independent Trustee company, with a fiduciary responsibility to act in the best interests of superannuation members, investors and beneficiaries (referred to collectively as "consumers" hereafter), EQT supports the intent of the regulation and shares the desire to ensure positive consumer outcomes. EQT has also had experience of implementing similar requirements in the UK and Europe under the MiFID II regime in our UK and Irish operations.

Notwithstanding the positive intent there are several practical considerations that arise from the draft Regulatory Guide, that may result in a failure to achieve the intended objective and / or present a significant challenge to operationalising the regime in a meaningful way.

In summary these include:

1. The absence of further guidance or prescription on consumer segments to drive Target Market Determinations (TMD) will undermine the efficacy of the regime, compromise achievement of the objectives and result in extraordinary cost for the industry (and ultimately consumers). Each product issuer will establish a different framework for TMD which will need to be monitored by distributors. This will result in potentially hundreds if not thousands of different frameworks attempting to be monitored. If one considers an IDPS as a distributor for example they will be faced with monitoring the distribution of products against TMD's for hundreds of products based on completely different frameworks. The resulting complexity will result in impractical outcomes, add tens of millions of dollars to the regulatory impact statement and a fail to achieve the regulatory objectives.

Proposed alternative: ASIC develop guidance on structured consumer cohorts (it may be more practical to do this by product sector e.g. insurance, superannuation, banking, managed investment schemes). It may be instructive to



adopt the guidelines developed by industry group UK Finance MiFID II Product Governance: Guidelines on Target Market Identification noting that the wider application of DDO across the industry will make a co-ordinated industry group led initiative much more difficult to effect in Australia.

2. The proposals appear to blur the lines between personal and general advice and factual information. As ASIC is aware this is a notoriously grey area and one consumer's likely find difficult to differentiate between. It is clear that DDO is not intended to replace or encroach on personal advice, where consumer protections in the form of best interest duties on Advisers, remain. However, the examples used to illustrate expected behaviours by distributors (e.g. Example 14: Renewal of general insurance policies) would almost certainly lead a consumer to conclude their individual personal circumstances are being considered in suggesting which products may or may not meet their objectives. While intent and legal form can be debated by ASIC and the industry this is unlikely to result in greater clarity for or understanding by consumers. This is a major flaw of the proposed regime that exacerbates an existing weakness in the provision of financial services.

Proposed alternative: Suggest revision of guidance on expectations on distributors outlined in RG000.163-RG000.183 to limit distributor interaction with the consumer to highlighting that this product may be unsuitable for consumers in their cohort rather than expecting further individual information is requested from consumers. An alternative might be to seek input from consumer panels around their interpretation of general and personal advice delineations in these circumstances noting that this may increase the scope of the activity markedly.

3. The utility of the proposed regime in the superannuation arena is unclear given superannuation is a compulsory (and therefore prima facie appropriate) product for all working Australians aged between 16 and 74. Given DDO obligations do not apply to MySuper and financial advisers have a best interest duty in advising a client (and DDO is specific in not replacing personal advice obligations) the challenge is in determining whether superannuation choice products have been distributed appropriately to members who have exercised choice (and thereby demonstrated a level of engagement with the product) in selecting their preferred option. There is no expectation that issuers and / or distributors understand the personal circumstances of consumers and therefore it is difficult to understand how this would operate in a way that gives effect to the regulatory intent. For example, two members, with an identical age, balance and salary profile, could quite reasonably, select two radically different choice options given their financial circumstances, their risk profile and their retirement objectives. Consequently, there will be wide dispersion in the products selected which will undermine the efficacy of any distribution monitoring.

Proposed alternative: DDO in relation to superannuation is restricted to the obligation on issuers to articulate a TMD for choice options and publicly disclosing through mandatory disclosure material and distributor materials consumers for whom the choice products may be suitable. Effectively this would provide superannuation distributors relief in relation to the ongoing monitoring obligations. This appears an appropriate amendment given superannuation's unique standing a Government mandated product and the lack of utility of any monitoring data given the absence of information on individual personal circumstance. We note in the UK and Europe where similar design and distribution regimes are in place the requirements are restricted to investment products and do not extend to the pension system.

4. The regulatory intent to provide greater balance in the protection of consumers beyond reliance on disclosure combined with ASIC's public denouncements of some



of the disclosure (presumably indicating a lack of utility) provides an opportunity to substantially reduce the disclosure regime to offset the significant cost impost of DDO.

Proposed alternative: ASIC revise its mandated disclosure requirements with a focus on increasing utility for consumers and reducing cost to the industry and ultimately consumers with the aim of balancing the cost benefit of the DDO regime.

5. The cost / benefit is simplistic and poorly articulated currently. The premise appears to be that good providers are largely meeting the requirements already and therefore it should be a limited marginal impost in terms of cost. This is not the case given the structure and scope of what is proposed in the draft Regulatory Guide. Giving effect to the Guidance in its current form would run to hundreds of millions of dollars across the industry. Inevitably, to ensure products remain economic, this will result in the cost of products to consumers increasing. This may be a reasonable price to pay for the desired outcomes. However, at present it is difficult to draw that conclusion given the benefits are also articulated in subjective and unquantified terms with no articulation of the number of consumers accessing inappropriate products currently and no estimation of the impact of the DDO. As a result it will be impossible to monitor the effectiveness of the new regime.

Proposed alternative: ASIC should quantify the current problem statement and estimate the expected impact for consumers as a result of the proposed reforms. A targeted data collection from product issuers and distributors on the direct (e.g. increased distribution) and indirect cost impact (e.g. the likely product development, data, systems and governance changes required) may aid ASIC in this regard.

Further responses to the specific questions posed in CP325 are included in Appendix 1.

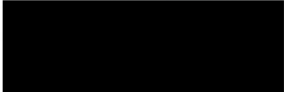
In conclusion, ASIC should be aware that the changes required to give effect to the DDO are substantial. Experience in the UK and Europe suggests that the full implementation and subsequent calibration of the regime will take a considerable time after April 2021 for both industry participants and the regulator to fully understand and react to the implications and tune their frameworks to achieve the objectives. This process is still continuing in the UK and Europe two years after the introduction of MiFID II. A facilitative and consultative approach from ASIC through this period is likely to be necessary to achieve the regulatory objectives.

Lastly, the finalisation of the guidance material is urgently required. The publication of the draft guidance eight months into a 24-month time period with a three-month consultation window has significantly reduced the time available for industry to respond appropriately.

Further delay in the finalisation of the guidance beyond June 2020 will make meaningful implementation extremely challenging, if not impossible, noting the current volume of regulatory change across the major regulators.

I trust this is instructive, if you have any further queries please do not hesitate to contact me.

Yours Faithfully,


Owen Brailsford
Chief Risk Officer



Appendix 1: Specific Questions posed in CP325

Comments are provided below on an exception basis – where the guidance is considered broadly useful or EQT has no further comment no comment is made.

CP325 Question Reference	ASIC Question	EQT Comments
C1Q1	Do you agree with our approach to guidance on the form and content of a target market determination? If not, why not?	No. The failure to give definitive guidance on the content and form of TMD, and in particular the formulation of a target market will result in significant complexity which will result in impractical outcomes, exponentially increase the cost and compromise the achievement of the regulatory objectives. Refer to comment number 1 in letter and proposed alternative.
C3Q1	Do you have any comments on our approach to guidance on identifying and describing the target market?	<p>There is an inference throughout the draft Guidance that the likely objectives, financial situation and needs of a class of consumers are homogenous and known, particularly to distributors. These are incorrect assumptions that take no account of very different circumstances, risk profiles and risk appetites of consumers who, prima facie present as similar, nor of distributors who will often have knowledge only of limited parts of the consumers objectives, financial situation and needs.</p> <p>Consequently, the expectation of what is achievable through DDO needs to be calibrated accordingly and balanced with the appropriate provision of information to consumers to help them make an informed choice. The ultimate responsibility for making a product choice, absent personal advice, must remain with the consumer. DDO is attempting to close the gap on the information asymmetry in relation to the product but the reverse asymmetry will continue to exist in relation to personal circumstance.</p>



C3Q2

Do you have any comments on the following examples, which have been used in our guidance to illustrate key principles set out in RG000.66-RG000.89

The framing of Example 3: Cash options in superannuation present a good example of a product for which different consumers (with similar characteristics) may have multiple objectives. The inference in the example is that the superannuation trustee should be most concerned with avoiding negative net returns and therefore reducing fees to best achieve this.

However, some members may be seeking capital security, others may be seeking a stable return profile and protection from volatility, some might be making a conviction choice with a view to returning to other asset classes in due course and others may be naturally conservative and distrusting of other asset classes.

The current economic environment means that it is unlikely many trustees will be able to generate positive returns with interest rates at historic lows and continuing to fall. As a result, some of these consumers would be better to move to a defensive income product, some would be better served in "cash-like" credit products and others might prefer to remain in cash with a negative return. In all cases the risk of inflation will continue to be their biggest risk with the real value of their investment continuing to recede. To this end the superannuation trustee as product issuer may be best to cease offering the product however this would mean the objectives of at least two of these sub-cohorts could not be met.

C3Q3

What additional matters, if any, do you consider to be relevant?

The illustration of an investment product as an example in this instance would be instructive

C7Q1

In relation to our guidance on how a target market determination should be

The guidance in respect to superannuation is a little confused and assumes commonality of objective according to external factors including financial situation and life-stage. Typically, it is more likely the commonality between members comes from a similar outlook on risk and or return objectives over a specific time period. As a result, the articulation of TMD is likely to resonate



CP325 Question Reference	ASIC Question	EQT Comments
	approached for superannuation products in Example 7 (a)-(d)	more with members in this context rather than arbitrary factors such as age, income and / or balance. The superannuation product set is complicated by its compulsory nature and therefore particular thought needs to be given to how the DDO obligations, particularly in relation to distributors who may have very limited knowledge of some aspects of a member's objectives, financial situation and needs at a point in time (e.g. an employer), apply to achieve the regulatory objectives. Refer to comments under item 3 in attached letter for proposed alternatives.
C8Q1	Do you have any comments on the following examples, which we have used in our guidance to illustrate key principles set out in RG000.107-RG000.120: (c) Example 9: Superannuation	Refer comments on C7Q1. In addition, the direct to public example is fundamentally flawed assuming Choice options are suitable for one set of members based on a set of criteria that might be known to the distributor (e.g. age and / or income) and suggesting filtering accordingly. In reality, a wide range of options may be appropriate for members based on their risk appetite and their financial situation which is known to them. Further the Employer aspect of this example assumes after initial default into a superannuation product that the employer plays any role in distribution and the selection of Choice for their employee – they do not. Refer to comments under item 3 in attached letter for proposed alternatives.
C8Q1	Do you have any comments on the following examples, which we have used in our guidance to illustrate key principles set out in	The example used is focused on the initial offer – EQT confirms this is the only point at which a TMD could be made noting that after issue the purchase of shares in a LIC is made on the open market



RG000.107-RG000.120:
(e) Example 11: Listed
Investment Companies

D1Q1

Do you agree with the factors listed in Table 5 of draft RG000 that we will take into account when considering whether a distributor has met the reasonable steps obligation? If not, why not?

The Reliance on existing information about a consumer and specifically the guidance in respect to seeking further information from the consumer is where the line in relation to general and personal advice becomes very blurred and arguably indistinguishable to a consumer. A consumer providing further information to a distributor to aid the distributor in concluding whether they fit a particular cohort, for whom the product is appropriate would reasonably conclude that their personal circumstances have been taken into account in the "recommendation" of a product. This is a major flaw in the application of the proposed regime.

Refer to comments under item 2 in the attached letter for proposed alternatives.

D2Q1

Do you have any comments on our proposed guidance for distributors in Example 14 of draft RG000?

Further to comments under D1Q1 above this example further illustrates a confused and blurred line in relation to general and personal advice particularly in respect to the last two paragraphs and proposed further steps. The conclusion is also counter intuitive in that the product in this example would still be offered. This is a flaw in the application of the proposed regime. Refer to comments under item 2 in the attached for proposed alternatives.

The example also touches on one of the challenging aspects of DDO that is not addressed in the consultation paper in respect to intended consequence. The extent to which DDO results in the restriction of product to consumers (including vulnerable consumers) who appear in particular groups but may value a product deemed unsuitable for their cohort should be explicitly addressed by ASIC. Example 1 in respect to credit cards and Example 5 in respect to funeral insurance are similar. Without opining on the value of those products specifically it is foreseeable that



CP325 Question Reference	ASIC Question	EQT Comments
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consumers who may value access to credit and or the piece of mind in purchasing funeral insurance would find it more difficult to access those products from reputable providers.

D3Q1	<p>Do you agree that in most cases a distributor would have sufficient information about a consumer through its existing sales processes to form a view on whether the consumer is reasonably likely to be in the target market for a financial product?</p>	<p>This will be highly variable by distributor. An IDPS for example will know a consumer's dealings through the IDPS but will have no greater insight on their overall financial position or objectives. Similarly, an employer in relation to superannuation will have little insight into financial situation and needs of their employees. Others such as financial advisers or accountants may be much better informed.</p>
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D3Q4	<p>Do you have any comments on our proposed guidance (in draft RG000.169) on how a distributor could reduce the likelihood of leaving a consumer with the impression that their personal circumstances have been considered?</p>	<p>Further to the responses D1Q1 and D2Q1 RG000.169 is confused and is highly likely to leave consumers with the impression their personal circumstances have been taken into account. This is a flaw in the application of the proposed regime. Refer to comments under item 2 in the attached letter for proposed alternatives.</p>
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CP325
Question
Reference

ASIC Question

EQT Comments

D4Q1

Do you have any comments on our proposed guidance on the content of the reasonable steps obligations in these circumstances?

The concept of degree and nature of harm is anticipated to be challenging to navigate. To use Example 14 to illustrate the issue, a value judgement would need to be made as to what is likely to cause consumers in this cohort more harm – the payment of a comprehensive insurance premium which may rationally be beyond their likely requirements given the age of the vehicle or the claim on a third party policy following an accident where the insured is unable to derive any value for the replacement of the vehicle. Necessarily these will become situational and it is highly likely AFCA would find in the direction of the consumer in either case. As outlined in the response to D2Q1 above further guidance on intended consequences by ASIC in this instance would be instructive (i.e. a view on which scenario is preferable).